RSC
Republican Study Committee
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Legislative Bulletin……………………………….………January 17, 2007

Contents:

Summary of the Bills Under Consideration Today:

Total Number of New Government Programs: 0

Total Cost of Discretionary Authorizations: $0

Effect on Revenue: $0

Total Change in Mandatory Spending: decreased by $65 million over five years

Total New State & Local Government Mandates: 0

Total New Private Sector Mandates: 0

Number of *Bills* Without Committee Reports: 1

Number of *Reported* Bills that Don't Cite Specific Clauses of Constitutional Authority: 0

H.R. 5—College Student Relief Act of 2007 (*Miller, D-CA*)

Order of Business: The bill is scheduled to be considered on Wednesday, January 17, 2007, likely pursuant to a closed rule, providing for three hours of debate.

Summary: H.R. 5 would gradually reduce (over five years) the interest rate on subsidized Stafford loans provided to undergraduate students through both the Federal Family Education Loan (FFEL) and the William D. Ford Direct Loan (DL) programs. As of July 1, 2006, Stafford loans have a fixed interest rate of 6.8%. H.R. 5 would decrease this fixed interest rate as follows:

- July 1, 2007 – July 1, 2008: 6.12%
- July 1, 2008 – July 1, 2009: 5.44%
- July 1, 2009 – July 1, 2010: 4.76%
- July 1, 2010 – July 1, 2011: 4.08%
- July 1, 2011 – January 1, 2012: 3.40%

NOTE: The 3.40% interest rate would be available to students for loans that originate between July 1, 2011 and January 1, 2012—only six months. As of January 2, 2012, the interest rate would revert back to 6.8%.

H.R. 5 includes a number of provisions designed to recoup the costs incurred by decreasing interest rates. The bill would reduce the percentage that most lenders are reimbursed for defaulted loans from 97% to 95%. This provision would take effect with respect to loans made on or after July 1, 2007.

The bill would gradually reduce, from 23% to 18%, the amount that guarantee agencies earn from the money recovered from defaulted borrowers. H.R. 5 would also eliminate the "exceptional performer status" for lenders, effective July 1, 2007. Under current law, if a lender meets certain criteria and qualifications, the government increases the payment to them to cover costs associated with defaulted loans. In addition, H.R. 5 would increase the current one-time consolidation loan offset fee (paid by lenders to the government) on the principal amount of consolidated student loans from .5% to 1%, effective July 1, 2007.

H.R. 5 would decrease the special allowance rate (SAR) by .01%. Utilized under FFEL loans only, SAR is the rate at which the federal government provides payments to lenders in compensation for the difference between the mandated borrower rate for federal loans and current market interest rates. Although this provision would decrease the formula through which lenders are reimbursed, the significantly decreased interest rates will generate a large increase in federal payments to lenders.

Finally, H.R. 5 would increase from 1.05% to 1.30%, an interest payment rebate fee applied to lenders with loan holdings that are at least 90% consolidation loans.

Additional Background: The federal government provides subsidized and unsubsidized loans to parents and students of higher education (both undergraduate and graduate) using two major programs: the FFEL and the DL program. The FFEL loan program offers loans provided to students from private lenders. Conversely, in the DL program, the federal government provides the capital for all loans. In FY 2005, these two programs provided $56.2 billion in *new* loans.

In those loans which are subsidized by the federal government, the government pays the interest while the student is enrolled as at least a part-time student. The government does not pay the interest on unsubsidized loans. Currently the interest charged on federal student loans varies among the different types of loans offered—ranging from 6.8% to 8.5%. As of July 1, 2006, all Stafford loans have a fixed interest rate of 6.8%.

The government guarantees a fixed return to lenders providing federal loans. As such, by reducing costs incurred upon the student by decreasing the interest rate, the federal government—i.e. taxpayers—must make up the shortfall to the lender.

Possible Conservative Concerns: While the cost of attending college has risen rapidly in the last decade, federal aid provided for postsecondary education has almost doubled in the same timeframe, reaching $94 billion in FY 2006. Despite the claim that Republicans had conducted a "raid on student aid," in recent years, Congress has substantially increased federal loan limits. Some experts contend that the significant rise in federal aid has actually contributed to increased college tuition. As the federal and state governments absorb an increasingly large portion of college expenses, institutions of higher education can raise tuition at taxpayers' expense, without the student or their families being held accountable for the cost.

A recent Heritage Foundation report suggests that federal postsecondary aid is not only provided to low-income families, but also to middle-class families. The essay stated that, "An increasing share of federal grant and loan subsidies are being provided to students from non-economically disadvantaged families. The College Board recently reported that 'changes in student aid policies have benefited those in the upper half of the income distribution more than those in the lower half.' A recent Department of Education report found that 47 percent of students from middle-income families accepted federal loans in 2000, compared to 31 percent in 1993."

Some conservatives may also be concerned that enacting H.R. 5 is part of a larger effort by some lawmakers to breathe new life into the DL program, and at the same time, stifle the FFEL program. In the 109th Congress, Senator Kennedy was the primary sponsor of S. 754, the Student Aid Reward Act of 2005, which sought to encourage universities to use the DL program, instead of participating in the FFEL program. As previously noted, in the FFEL program, the loan capital is provided by private lenders. The FFEL program has been extremely successful in efficiently providing students with access to college loans. In fact, according to a report by America's Student Loan Providers, as of 2004, 83% of schools used FFEL program exclusively to provide financial assistance to students. At that same time, only 11% of schools used only the DL program, while the remaining 6% utilized both.

Many of the offsets in H.R. 5 will increase the costs for lenders to provide loans through the program. As such, some conservatives may be concerned that this legislation may discourage lenders from participating in the FFEL program, or make the DL program more appealing, as lenders seek to recoup their costs by charging fees.

In addition, some conservatives may be concerned that this bill may not actually increase access to college at all. This bill reduces the cost of interest that is repaid after students have presumably graduated or finished their tenure in school. Now working, many of these individuals are likely to be in an adequate position to fully pay the interest on their loans. Such "back-end" assistance is undoubtedly beneficial to each individual after school, but it is unclear to what extent it helps expand access to college in the first place. This is a line of argument reflected in the Administration's SAP.

Committee Action: On January 12, 2007, the bill was referred to the Committee on Education and Labor, which took no official action.

Administration Position: According to the Statement of Administration Policy (SAP), the Administration opposes H.R. 5. Specifically, the SAP states, "Reducing student loan interest rates would direct Federal subsidies to college graduates, not to students and their families who are struggling to meet current and future educational expenses. College graduates have higher lifetime earnings, and can already take advantage of flexible repayment options available under current law and reduce the effective interest rate they pay through the existing tax deduction for student loan interest. Student debt loads have soared in recent years, and it is not clear that encouraging more loans is a wise course."

Cost to Taxpayers: According to CBO, the cost of the student loan interest rate reduction is $7.1 billion over five years. However, as a result of offsets (reductions in lender subsides) included in the legislation, the bill would reduce direct spending by $65 million over five years. It is important to note that the bill sunsets the interest rate reductions to comply with the ten-year test of the new House PAYGO rule. In short, the offsets in the bill would not have paid for the new spending over 10 years.

Does the Bill Expand the Size and Scope of the Federal Government?: Yes. The bill would significantly expand the government's subsidization of higher education.

Does the Bill Contain Any New State-Government, Local-Government, or Private-Sector Mandates?: No.

Constitutional Authority: A committee report citing constitutional authority is not available.

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